

Best of Times or Worst?

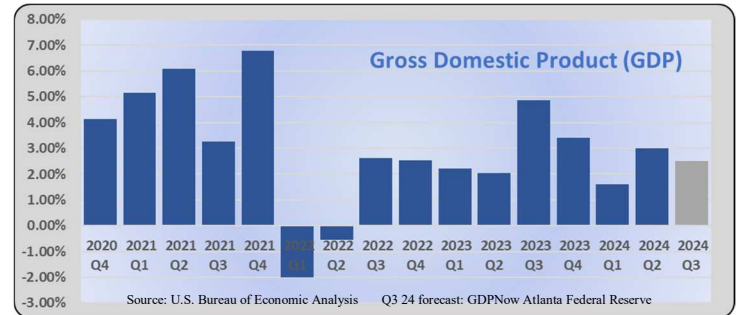
Charles Dickens' first line from the *Tale of Two Cities*, "**It was the Best of Times, it was the Worst of Times**", is as fitting today as it was in 1859. Over the last two years, many pundits proclaimed that **the Worst of Times** were right around the corner as the Fed's high interest rates would drive our economy into a recession. Even now the New York Fed's recession probability forecasts a 61.8% probability of a recession within the next 12 months.

Other experts have a more optimistic feeling that this is **the Best of Times** due to the impressive strength of the US economy buoyed by our strong labor market, real wage gains, and falling inflation. Consumers were nervous during the summer months, but now are growing a little more optimistic about the economy with the prospects of lower interest rates and lower inflation.

The Federal Reserve's record of orchestrating a "soft landing" has been dismal. Many times Fed tightening causes our economy to sink into recession. A "soft landing" is when the Fed's tightening doesn't trigger a recession. The Federal Reserve Chair, Jerome Powell, took aggressive action to squelch the post-pandemic inflation spike by raising the Fed Rate 11 times from March and July 2022 from near 0% to 5.5%, the fastest rate increases in history.

Many felt like these were **the Worst of Times** with the Fed's interest rate hikes stocking recession fears which permeated the news media. The Fed has kept those rates higher for longer than expected due to the strength of the economy and the labor market which have thrived in spite of the economic headwinds of high interest rates.

Now, more confident that inflation has been subdued, the Fed has begun rate reductions. At their September meeting, the Fed kicked off the long awaited series of rate cuts with a larger-than-usual half-point reduction to 4.75% and have penciled in quarter-point rate cuts both in November and December. The Fed anticipates lowering rates to 4.25% by the end of 2024, to 3.5% in 2025, and below 3.0% in 2026. Lower Fed rates will lower mortgage interest rates unlocking the housing logjam for both existing and new homes while car loans and credit cards will also cost less. The Fed's aim is to stimulate the economy and employment in order to avoid a recession. A "soft landing" would be **the Best of Times**.

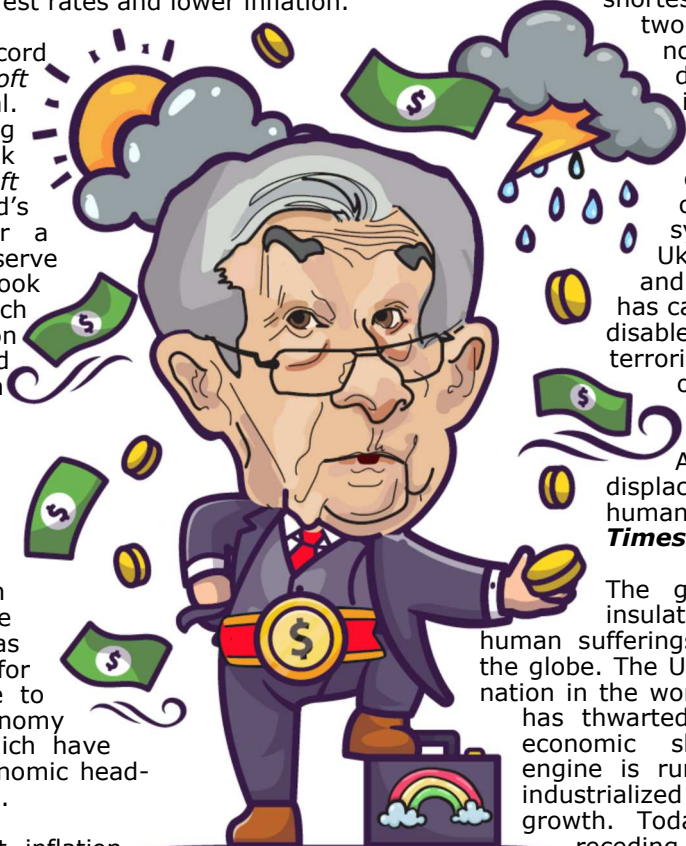


The basic criteria to determine a recession is two quarters of negative GDP contraction, although the National Bureau of Economic Research (NBER) is the official arbiter of when recessions begin and end. The chart above depicts the substantial rebound in GDP following the pandemic recession which lasted just 2 months, the shortest recession on record. The next two negative quarters were deemed not to result in a recession by NBER due to consumer stimulus spending and a strong job market.

Geopolitical shocks are the greatest threat to the stability of our country and our financial system. Russia's invasion of Ukraine with mass infantry assaults and heartless bombing of civilians has caused countless deaths. Israel has disabled the Hamas and Hezbollah terrorist groups, but at an extreme cost of the collateral damage, civilian deaths and dislocations that will last for generations. 30 million African refugees are internally displaced due to oppressive regimes and human rights abuse. It is **the Worst of Times** for many parts of the world.

The geographic isolation of the US insulates us from day in and day out human sufferings and horrors that exist around the globe. The United States is the most powerful nation in the world. American economic resilience has thwarted the pundits' predictions of an economic slowdown. America's economic engine is running at full speed while other industrialized nations have struggled to regain growth. Today's America is a nation with receding inflation, historically low unemployment, soaring stock and bond markets, and interest rates, while still elevated, falling due to action by the Federal Reserve.

The United States is the world's beacon of liberty, hope and opportunity. Dickens cautions that **the Best and Worst of Times** exist concurrently. There will be more challenges ahead, but let's hope that the future holds a little more of **the Best of Times**.



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